

Message Text

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C O N F I D E N T I A L STATE 124699

PARIS FOR OECD

E.O. 11652: GDS

TAGS: EFIN, OECD

SUBJECT: MEETING OF EPC WP-3, MAY 25, 1977

1. WP-3 SESSION MAY 25 CONCENTRATED ON DISCUSSION OF THREE
ISSUES POSED IN SECRETARIAT PAPER CPE/WP3(77)7: (1)
GENERAL DIRECTION IN WHICH PAYMENTS PATTERNS SHOULD BE
MOVING; (2) INSTRUMENTS OF ADJUSTMENT AND (3) SPEED OF AD-
JUSTMENT. JAPANESE MADE BRIEF STATEMENT ON CURRENT TRENDS
AND POLICIES IN JAPAN. OVERALL TONE WAS ONE OF GUARDED OP-
TIMISM, PARTICULARLY WITH RESPECT TO COUNTRIES REPRESENTED
AT MEETING. SHIFT OF U.S. CURRENT ACCOUNT INTO SUBSTANTIAL
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DEFICIT SEEN AS MAJOR CONTRIBUTION TO SUSTAINABLE WORLD
PATTERN. THERE APPEARED TO BE CONSENSUS THAT THE MAIN PROB-
LEM IN THE WORLD PAYMENTS PATTERN WAS IN SMALLER MEDITER-
RANEAN COUNTRIES -- TURKEY, SPAIN AND PORTUGAL. WHILE
SCANDINAVIAN DEFICITS WERE LARGE, GOVERNMENTS APPEARED TO BE
TAKING CORRECTIVE ACTION. SEVERAL DELEGATES EMPHASIZED IM-
PORTANCE OF REDUCING SURPLUSES OF FEW STRONG COUNTRIES. IN
GENERAL, WP AGREED THAT DEMAND MANAGEMENT AND EXCHANGE RATE
INSTRUMENTS SHOULD BOTH PLAY IMPORTANT ROLES IN ENCOURAGING
CHANGE IN PATTERNS. "REAL" CHANGES IN EXCHANGE RATES WERE

NEEDED. FINANCING WOULD HAVE TO BE PROVIDED IN SOME CASES BECAUSE REQUIRED STRUCTURAL READJUSTMENTS WOULD TAKE TIME.

PRIVATE MARKETS WERE WORKING WELL BUT OFFICIAL FINANCING WOULD BE NEEDED AS WELL AS TECHNIQUES TO INDUCE COUNTRIES TO INITIATE ADJUSTMENT MEASURES BEFORE CRISIS STAGE REACHED. END SUMMARY.

2. SCHWARTZ (IMF) SAID THAT ALTHOUGH "ENORMOUS" PROBLEMS REMAIN, VERY IMPORTANT ADJUSTMENTS ARE UNDERWAY IN 1977 -- E.G., U.S., ITALY, U.K. THESE CHANGES AFFORDED GROUNDS FOR OPTIMISM.

3. CHAIRMAN EMMINGER CIRCULATED TABLE ON CURRENT ACCOUNT BALANCES WHICH ISOLATED U.S. BUT AGGREGATED REST OF WP-3 COUNTRIES. SOLOMON (U.S.) QUESTIONED APPROPRIATENESS OF PRESENTATION WHICH, BY COMBINING SURPLUSES OF JAPAN, GERMANY, SWITZERLAND AND THE NETHERLANDS WITH CANADIAN AND FRENCH DEFICITS, GAVE ERRONEOUS IMPRESSION OF WHOLLY SATISFACTORY POSITION FOR EACH OF THESE COUNTRIES. ALSO QUESTIONED WHETHER THIS GROUP OF COUNTRIES SHOULD HAVE CURRENT ACCOUNT SURPLUSES IN 1978. MAYNARD (U.K.) ARGUED FOR ACTION BY SURPLUS COUNTRIES. SAID FINANCING NOT RIGHT ANSWER BECAUSE SOME DEFICIT COUNTRIES SHOULD NOT BORROW MORE. DE LAROSIERE (FRANCE) PINPOINTED JAPAN AS "HARD CORE" PROBLEM ALONG WITH SMALL OECD COUNTRIES. KESSLER
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(NETHERLANDS) SAID DUTCH COULD ACCEPT SOME REDUCTION OF SURPLUS RESULTING FROM ACTIONS OF OTHERS, BUT WOULD FIRMLY RESIST SWING INTO DEFICIT WHICH, HE SAID, WAS OUTSIDE THEIR "MARGIN OF INDIFFERENCE." COULD NOT EXPAND ECONOMY GIVEN HIGH INFLATION RATE AND UNWILLING ACCEPT EXCHANGE RATE ADJUSTMENT BECAUSE GAS EXPORTS, WHICH ARE RESPONSIBLE FOR THE SURPLUS, EXPECTED TO DIMINISH IN FIVE YEARS.

4. SOME MEMBERS QUESTIONED EXTENT TO WHICH SWING IN U.S. POSITION WAS RESULT OF CYCLICAL FACTORS. SOLOMON RESPONDED THAT U.S. HAD NOT QUANTIFIED CYCLICAL ASPECT. RELATIVE GROWTH RATES IN US AND OTHER MAJOR COUNTRIES CONTRIBUTED TO DEFICIT BUT VARIATIONS IN LEVEL OF CAPACITY UTILIZATION IN US ITSELF APPEARED TO HAVE MAJOR IMPACT ON IMPORTS. THUS, IT SEEMED LIKELY THAT DEFICIT WOULD CONTINUE TO BE SUBSTANTIAL IF US ECONOMY WERE OPERATING CLOSE TO FULL CAPACITY.

5. IN DISCUSSING EFFECTS OF US CURRENT ACCOUNT SWING SOLOMON OFFERED CRUDE ALLOCATION AMONG AREAS AS FOLLOWS: OPEC \$5 BILLION; LDOS \$2 TO \$3 BILLION; OECD \$4 TO \$5 BILLION.

6. NEUFELD (CANADA) DREW ATTENTION TO IMPORTANCE OF PRO-

PER UTILIZATION OF BORROWED FUNDS IN DETERMINING WHETHER CURRENT ACCOUNT DEFICITS WERE SUSTAINABLE AND THUS WHETHER THEY PRESENTED PROBLEM. SIZE OF A DEFICIT WAS NOT, BY ITSELF, AN INDICATION OF UNSUSTAINABILITY. NOTED LONG-STANDING STRUCTURAL TENDENCY FOR CANADA TO INCUR CURRENT ACCOUNT DEFICITS. THOUGHT MONEY BORROWED BY CANADA BEING USED WELL AND CONTINUING DEFICIT NO PROBLEM.

7. SKANLAND (NORWEGIAN MEMBER OF SWEDISH DELEGATION) CALLED ATTENTION TO SIMILAR SITUATION WITH RESPECT TO HIS COUNTRY'S DEFICIT WHICH CONSTITUTED SUBSTANTIAL PROPORTION OF THE "SMALL OECD" COUNTRY DEFICIT WITH WHICH CONCERN HAD CONFIDENTIAL

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BEEN EXPRESSED. SAID OTHER NORDIC COUNTRIES EXPECTED SIGNIFICANT REDUCTION IN DEFICITS OVER NEXT YEAR AND NO FINANCING PROBLEMS EXPECTED.

8. EMMINGER FORECAST GERMAN CURRENT ACCOUNT SURPLUS OF \$1-1/2 TO \$2 BILLION IN 1977. MATSUKAWA EMPHASIZED STRUCTURAL NATURE OF JAPANESE ECONOMY WHICH MADE RAPID MOVE FROM SURPLUS TO DEFICIT DIFFICULT. ADVOCATED "SLOW AND STEADY" MOVEMENT TOWARD DESIRED PATTERN INDICATING THAT SUSTAINABILITY DEPENDED ON FINANCING. IN LATER DEFENDING JAPANESE CURRENT ACCOUNT SURPLUS, MATSUKAWA EMPHASIZED AN EXPECTED SLOWING OF EXPORTS AND RISE IN IMPORTS ALONG WITH A WIDENING OF THE INVISIBLES DEFICIT. EXPECTED A 1977 SURPLUS OF LESS THAN \$6 BILLION FORECAST BY SECRETARIAT BUT DID NOT SAY BY HOW MUCH.

10. VAN YPERSELE (CHAIRMAN OF TEMPORARY WORKING PARTY) NOTED THAT SMALL COUNTRIES WITH 11 PER CENT OF THE OECD GNP HAD 3/4 OF THE OECD DEFICITS. IN THESE COUNTRIES, CURRENT ACCOUNT DEFICITS AVERAGE 5 PERCENT OF GNP. INFLATION RATES ARE VERY HIGH. SOCIAL, ECONOMIC AND POLITICAL FACTORS MAKE IT DIFFICULT FOR THEM TO REDUCE GROWTH RATES AND DEMAND CONTINUED TO GROW MORE RAPIDLY THAN IN LARGER COUNTRIES. HE FEARED SERIOUS FINANCIAL PROBLEMS IN TURKEY, PORTUGAL AND SPAIN. MARRIS SAW NO ALTERNATIVE TO SEVERE STABILIZATION MEASURES AND NO WAY TO AVOID FINANCIAL PROBLEM.

11. DIVERGENT VIEWS WERE EXPRESSED RE WHERE THE MAJOR RESPONSIBILITY FOR CORRECTIVE ACTION SHOULD FALL AS WELL AS ON RELATIVE IMPORTANCE OF AVAILABLE INSTRUMENTS. MAYNARD INSISTED ONUS SHOULD FALL ON STRONGER COUNTRIES TO REDUCE EX ANTE SURPLUS OF SAVINGS. WEAKER COUNTRIES COULD NOT AS A PRACTICAL MATTER ABSORB THIS SWING BECAUSE OF FEAR OF IMPOSITION OF DOMESTIC RESTRAINT, CONCERN OVER

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GROWING DEBT SERVICE REQUIREMENTS, AND ANTI-INVESTMENT EFFECTS OF HIGH REAL RATES OF INTEREST. IMPORTANT TO ACHIEVE CHANGED PAYMENTS PATTERN AT HIGH LEVELS OF ECONOMIC ACTIVITY. SEVERAL MEMBERS DISAGREED. KESSLER ASSERTED DUTCH INABILITY TO TAKE INITIATIVE GIVEN DOMESTIC INFLATION. WEBER (GERMANY) FELT ONUS WOULD HAVE TO REST ON COUNTRIES WITH RELATIVELY HIGH INFLATION RATES. NEUFELD FELT IT WAS UP TO BORROWING COUNTRY TO OFFER RATES OF RETURN SUFFICIENT TO ATTRACT FUNDS WHICH, HE FELT, COULD BE DONE PROVIDED BORROWED CAPITAL WAS PROPERLY USED FOR PROJECTIVE INVESTMENT.

12. DE LAROSIERE THOUGHT SPECIAL ACTION NEEDED -- PREFERABLY EXPANSION BY STRONGER NATIONS BUT IF THIS NOT POSSIBLE LONG-TERM CAPITAL SHOULD BE PROVIDED. DE LAROSIERE REITERATED EARLIER FRENCH ASSERTIONS THAT DEPRECIATION HAS NOT BENEFITED FRENCH EXPORTS, THAT FRENCH IMPORTS ARE VERY PRICE INELASTIC AND NATURAL STABLE EXCHANGE RATE STABILITY HAD HELPED FIGHT DOMESTIC INFLATION. ADVOCATED VERY CAUTIOUS USE OF EXCHANGE RATE INSTRUMENT. MAGNIFICO (ITALY) REITERATED FAMILIAR ITALIAN VIEW THAT WAGE INDEXING SYSTEM MADE IT IMPOSSIBLE FOR ITALY TO IMPROVE COMPETITIVENESS THROUGH EXCHANGE RATE CHANGE.

13. WEBER, ON OTHER HAND, THOUGHT ROLE OF EXCHANGE RATES VITAL. NEUFELD POINTED OUT THAT "REAL" EXCHANGE RATE CHANGES WOULD BE GRADUAL AND THAT EXCHANGE RATE PROBLEMS AROSE LARGELY OUT OF FAILURE OF DEMAND MANAGEMENT.

14. SOLOMON SUGGESTED ESTABLISHMENT OF WP SUB-GROUP TO EXAMINE STRUCTURAL IMPEDIMENTS TO RAPID ADJUSTMENT AND ROLE OF EXCHANGE RATES IN ADJUSTMENT. FELT WP NEEDED CLEARER IDEA OF EXTENT TO WHICH CHANGES IN NOMINAL RATES WERE MAKING POSITIVE CONTRIBUTION TO ADJUSTMENT. MAYNARD AND EMMINGER EMPHASIZED TIME LAGS INVOLVED IN IMPACT OF EXCHANGE RATE CHANGE ON TRADE.
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15. MARRIS CONCLUDED THAT IN FOLLOWING POLICIES TO WHICH THEY COMMITTED THEMSELVES AT LONDON SUMMIT, MAJOR COUNTRIES APPEARED TO BE GOING AS FAR AS FEASIBLE THROUGH DEMAND MANAGEMENT, LEAVING FURTHER ACTION TO EXCHANGE RATES AND DEMAND MANAGEMENT IN SMALLER COUNTRIES. CHANGES IN REAL EXCHANGE RATES APPEARED NECESSARY.

16. LAMFALUSSY (BIS) GAVE EXTENDED REPORT ON BANK LENDING OUTLOOK -- CONCLUDING THAT PRIVATE BANK LENDING LIKELY TO CONTINUE AT SUBSTANTIAL BUT SOMEWHAT SLOWER PACE (SOLOMON NOTED U.S. ESTIMATE THAT TOTAL PRIVATE LENDING REACHED

RECORD PACE AT ABOUT \$30 BILLION IN FIRST FOUR MONTHS OF 1977). LAMFALUSSY SAID THAT SIGNIFICANT SHIFTS IN IDENTITY OF BORROWERS WERE OCCURRING AND THAT ONLY A FEW COUNTRIES APPEARED TO POSE SERIOUS REPAYMENT RISK.

17. EMMINGER RAISED QUESTIONS OF DEVELOPING "STANDARDS OF GOOD BEHAVIOR" WHICH BANKS MIGHT BE URGED TO FOLLOW IN THEIR LENDING. WEBER SUGGESTED PRIVATE LENDERS AVOID GENERAL BALANCE OF PAYMENTS LENDING NOT LINKED TO IMF PROGRAMS. OTHERS RAISED CAUTION FLAGS, NOTING PRIVATE MARKETS WORKING WELL AND THAT BALANCE OF PAYMENTS LOANS DIFFICULT TO DISTINGUISH IN CASE OF BORROWING BY NATIONALIZED INDUSTRIES.

18. SEVERAL SPEAKERS WARNED AGAINST TOO-EASY AVAILABILITY OF FINANCING WHERE COUNTRIES ARE RELUCTANT TO ADOPT CORRECTIVE MEASURES ALTHOUGH WP RECOGNIZED THAT STRUCTURAL DIFFICULTIES OF ADJUSTMENT MADE CONTINUED FINANCING ESSENTIAL. VAN YPERSELE ADVANCED THE OBSERVATION THAT PORTUGUESE FINANCING NEED MIGHT BE MET BY OECD FINANCIAL SUPPORT FUND IF IT COULD BE BROUGHT INTO OPERATION.

19. MEETING ADJOUNED WITHOUT ANY DISCUSSION OF SPECIFIC
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WORK PROGRAM, DATE FOR NEXT MEETING OR MEETING AGENDA.

20. INFORMAL AGREEMENT APPEARS TO HAVE BEEN REACHED ON SELECTION OF MICHIIYA MATSUKAWA, JAPANESE VICE MINISTER OF FINANCE, TO REPLACE EMMINGER AS WP CHAIRMAN AND ON KIT MCMAHON OF BANK OF ENGLAND AS VICE CHAIRMAN.
CHRISTOPHER

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